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INTERNATIONAL COUNTERTRADE

Draft legal guide on drawing up contracts in international countertrade transactions: sample chapters*

Report of the Secretary-General

Addendum

VI. PRICING OF GOODS

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* The text contained herein is a first draft prepared by the Secretariat for consideration by the Commission as part of the preparatory work on the draft legal guide on drawing up contracts in international countertrade transactions and should not be regarded as stating the views of the Commission.

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A. General remarks

1. It is advisable that the parties specify in the countertrade agreement the price of the goods that will be the subject matter of the future supply contract, if they are able to do so. When the parties are not able to set the price in the countertrade agreement, it is advisable to provide a method for determining the price at the time the supply contract is to be concluded. This chapter deals with methods for determining the price after the countertrade agreement has been concluded. In addition, the chapter discusses the currency in which the price is expressed and revision of price.

2. The parties may need to defer setting the price, for example, because the type of goods has not been identified at the time of the conclusion of the countertrade agreement or because there is to be a long interval between the conclusion of the countertrade agreement and the conclusion of a given supply contract. Such an interval may prompt the parties to defer setting the price because of the possibility of price fluctuation or of a change in the underlying economic conditions during the interval. In some cases, the parties may set the price of an initial shipment, but leave the determination of the price of subsequent shipments for a later time. Providing a method for determining the price may help the parties avoid differences over what the appropriate price should be, which may delay or prevent the conclusion of supply contracts.

3. In a barter transaction, it may not be necessary to include a provision on price because the goods shipped in one direction constitute payment for the goods shipped in the other direction. Nevertheless, pricing issues may arise in a barter transaction if the parties decide to measure the relative value of their shipments in monetary terms, rather than merely in terms of volume and quality, or if the shipments are of different values and the imbalance is to be settled in money. Pricing would also be necessary when customs regulations require that goods entering a country indicate a monetary value.

4. In setting the price of the countertrade goods, it is advisable that the parties specify whether or not the price includes costs ancillary to the costs of the goods themselves, such as transportation or insurance, testing, or customs duties and taxes. Some of the elements of the price may be indicated by using an appropriate trade term such as those defined in the INCOTERMS of the International Chamber of Commerce.

5. The parties may wish to stipulate the point of time when the price is to be calculated, particularly in the case of goods whose price may fluctuate. When the countertrade transaction involves a single shipment or a number of shipments within a relatively short period of time, and the price is to be determined only once, a specified date may be agreed upon. In some cases, the price setting mechanism may be set in motion by an event such as the start-up of a plant under a buy-back transaction or the placing of an order. When multiple shipments are spread out over a longer period of time, several dates for determination of price may be agreed upon or the countertrade agreement may provide a mechanism for revision of the initial price.

6. The parties should bear in mind that there may be mandatory rules that affect the level at which the price may be set. For example, if the price is set at a low level in relation to the market price, the goods may be subject to anti-dumping import restrictions.

B. Currency of price

7. The currency in which the price is to be paid may involve certain risks arising from the fluctuation in the purchasing power of that currency and from the fluctuation in exchange rates between that currency and other currencies. If the price is to be paid in the currency of the supplier's country, the purchaser bears the consequences of a change in the exchange rate between that currency and the currency of the purchaser's country. The supplier, however, will bear the consequences of a change in the exchange rate between the currency of the supplier's country and the currency of another country in which the supplier has to pay for equipment, materials or services needed in the production of the goods. If the price is to be paid in the currency of the purchaser's country, the supplier bears the consequences of a change in the exchange rate between this currency and the currency of the supplier's country. If the price is to be paid in the currency of a third country, each party bears the consequences of a change in the exchange rate between this currency and the currency of its respective country. Where a financing institution has granted the purchaser a loan for the purchase of the goods, the purchaser may prefer the price to be paid in the currency in which the loan is granted.

8. In stipulating the currency in which the price is to be paid, the parties should take into consideration foreign exchange regulations and international treaties in force in the countries of the supplier and the purchaser, which may mandatorily govern this question. The parties should also take into account that under some legal systems the price in an international contract must be paid in the currency in which it is denominated, while other legal systems may permit, or even require, payments in the currency of the place of payment, even if the price is denominated in a foreign currency.

9. The countertrade agreement may denominate the price in a currency that the parties consider to be stable or in a unit of account that is not a national currency, but provide that it is to be paid in another currency. The effects of such an approach are similar to those achieved by a currency clause (see paragraphs 37 and 38, below), and restrictions imposed by the applicable law in respect of currency clauses may also apply to such provisions. If this approach is used, it is advisable to agree in the countertrade agreement that the exchange rate is to be the one prevailing at a specified place on a specified date.

10. It is not advisable for the contract to denominate the entire price in two or more currencies, and allow either the debtor or the creditor to decide in which currency the price is to be paid. Under such a clause, only the party having the choice is protected, and the choice may bring the party having the choice unjustified gains.

C. Determining price after conclusion of countertrade agreement

1. Standards

11. The countertrade agreement may provide for a determination of price through the use of a standard (see chapter III, "Contracting approach", paragraph 50). Such a method provides a price at the time of the conclusion of the supply contract in an objective manner not influenced by the will of the parties.

12. The parties may wish to include a procedure to apply in the event a standard they select proves to be unworkable (e.g., because a market price is not available as expected). For example, the parties may provide that the price is to be determined through the use of an alternate standard or that the price is to be determined by a third person.

(a) Market prices for goods of standard quality

13. When goods identified in the countertrade agreement are commodities or semi-finished products (e.g., grains, oil, metals, wool) for which prices are regularly reported, the parties may agree to link the price of the countertrade goods to the reported price. Where the goods are traded on several exchanges or in several markets, the parties are advised to specify a particular exchange or market to which reference will be made. In order to protect against price fluctuations, the standard may call for an average of the prices reported at several agreed points of time (e.g., the prices reported on the first business day of the month for the six months preceding the date of the determination of the price).

(b) Production cost

14. The parties may agree that the price is to be based on the supplier's cost of producing the goods, plus an amount to cover the supplier's overhead and profit. Such an approach may be selected when the exact cost of various inputs cannot be anticipated at the time the countertrade agreement is concluded. In order to limit the purchaser's risk of having to pay an excessive price, it is advisable that, where possible, the parties stipulate in the countertrade agreement the quantity of inputs (e.g., raw materials, energy and labour) that will be required for the production of one unit of the goods. The parties may also wish to stipulate that the supplier should maintain records reflecting production costs in accordance with forms and procedures required by the purchaser, and that the purchaser shall have access to those records.

(c) Competitor's price

15. The price may be determined on the basis of the price charged by an identified competitor producing the same type of goods as those that will be delivered under the supply contract. If the countertrade agreement does not identify the competitor, it may establish criteria for the selection of a competitor (e.g., geographical criteria or criteria related to the volume of production of the same type of goods). Because the competitor may sell a product at different prices in different geographical regions and markets, it is advisable that the countertrade agreement identify the market to which reference will be made. The price clause could also indicate how the price information will be obtained and the date as of which the competitor's price is to be determined. Furthermore, the parties may agree to exclude specially discounted prices charged to certain customers (preferential prices). For example, the standard may exclude prices charged for the goods when they are purchased by disaster relief organizations or by employees of the supplier.

16. A competitor's price may not be relevant, without adjustments, if it is based on a significantly larger or smaller quantity than the quantity intended to be purchased under the countertrade agreement. A competitor's price may also not be appropriate if the competitor's goods are of a different

quality, if the competitor's price is based on payment conditions (e.g., deferred payment) not being offered by the supplier of the countertrade goods, or if the amount of transportation costs or insurance and public charges contained in the competitor's price differs from what is to be included in the price of the countertrade goods. It is therefore advisable to stipulate that the standard should take into account only prices for shipments that are comparable in quantity, quality, delivery and payment conditions to the future supply contract, or that amounts should be added or subtracted from the competitor's price in order to compensate for differences.

17. The parties may agree that the price is to be determined on the basis of several competitors' prices. Such a clause may identify the competitors or it may provide that each of the parties is to obtain quotations from a specified number of competitors. If the competitors are not identified, it is advisable that a clause of this type specify the countries or regions from which the parties are to obtain the quotations. It is also advisable that the countertrade agreement indicate the manner in which the price is to be calculated (e.g., whether by calculating a mean or a median price). The parties may wish to specify the period of time during which the quotations are to be obtained. In doing so, the parties should take into account the length of time necessary to obtain the quotations as well as the need to base the calculation on current prices.

18. When the party committed to purchase goods manufactures the same type of goods, the parties may agree that the price will be determined on the basis of the price charged by the purchaser or on the basis of the purchaser's own cost of manufacture. Such an approach might be used, for example, in a buy-back transaction in which a producer of a certain type of goods sells a facility that produces that type of goods and agrees to buy back the resultant products.

(d) Most-favoured-customer clause

19. It may be agreed that the price of the countertrade goods will based on the lowest price at which goods of the same type are supplied by the supplier to other customers. In some cases, the parties may restrict the clause to a limited category of customers (e.g, customers in a particular country or customers identified in the countertrade agreement). The parties may wish to indicate the means to be used to identify the most-favoured customer. For example, the supplier could be required to provide specified types of information indicating the prices charged by the supplier to other customers. It is also advisable to ensure that the most-favoured-customer price is relevant to the shipments to be made pursuant to the countertrade agreement (see paragraph 16 above). The parties may also wish to specify the date as of which the most-favoured-customer price is to be determined. The parties may wish to specify any specially discounted prices (preferential prices) offered by the supplier to certain customers that should not be taken into account (see paragraph 15 above). The scope of the most-favoured-customer clause may be broadened by agreeing that the price will be determined on the basis of the lowest price charged by the supplier or by other specified suppliers of the same type of goods.

(e) Use of more than one standard

20. The countertrade agreement may provide that the price is to be determined by a formula involving two or more standards. For example, the

price may be determined by averaging the prices derived from the selected standards. Another possibility is for the price derived from a particular standard to be compared with prices derived from one or more other standards. If the difference between the price derived from the selected standard and the prices from the comparator standards does not reach a specified threshold, the price derived from the selected standard would apply. If the difference exceeds a specified threshold, the final price would be, for example, the average of the price derived from the standards. Such techniques may be useful when it is desired to avoid the possibility that the price derived through the use of a single standard might not reflect the market value of a given product at the time the purchase is to be made.

2. Negotiation

21. The parties may agree that the price is to be negotiated. For a discussion of procedures the parties may establish for the negotiations, see chapter III, "Contracting approach", paragraphs 39 to 42. It is advisable that, to the degree possible, the parties agree on guidelines for the determination of the price.

22. Such guidelines may establish minimum and maximum limits within which the price is to be negotiated. In establishing such limits, the parties may use price standards of the type described in paragraphs 11 to 20 above. For example, it may be agreed that the price should not be more than 5 per cent higher or more than 5 per cent lower than the price charged by a competitor.

23. Alternatively, guidelines may merely provide a reference price to be taken into account in negotiations. In formulating a guideline of this type, the parties may use price standards such as those described in paragraphs 11 to 20 above. For example, in may be agreed that the price will be negotiated taking into account the price of a particular competitor.

24. A negotiation guideline may also take the form of a statement that the price of goods is to be "competitive", "reasonable", or at a "world market" level. Such a clause might be acceptable when the goods are of a standard quality. A guideline of this type may be made more precise by specifying, for example, whether the price should be based only on prices paid to the supplier by other buyers or should also be based on prices charged by other suppliers, the period of time the parties should refer to in determining what is a "competitive", "reasonable" or "world market" price, and, if there are variations in prices in different markets, which markets, types of buyers or geographical territories are referred to.

3. Determination of price by third person

25. Sometimes the parties provide for the price to be set by an independent third person (e.g., a market specialist in the goods in question). For a discussion of determination of contract terms by third persons, see chapter III, "Contracting approach", paragraphs 53 to 60. Such an approach may also be used as an alternative price setting method in the event that an attempt by the parties themselves to set the price proves unsuccessful.

26. It is advisable for the countertrade agreement to delimit the mandate of the third person by providing guidelines of the type discussed with respect

to negotiation (paragraphs 21 to 24 above). The parties may wish to establish deadlines for referral of the matter to a third person, so that the price could be set in time to allow conclusion of contracts as planned.

4. Determination of price by one party

27. Sometimes it is agreed that the price will be determined by one of the parties to the countertrade agreement (see chapter III, "Contracting approach", paragraph 61). Legal systems that recognize determination of price by one party tend to require that such determination be subject to guidelines in order to be enforceable. In considering the type of guidelines to use (see paragraphs 21 to 24 above), the parties should bear in mind that legal systems differ as to the degree of precision required. Under some legal systems the determination of the price by one party must be subject to a standard of reasonableness or fairness. When the parties do not refer to a standard of reasonableness or fairness, some of these legal systems will imply a reference to such a standard. Other legal systems require that the latitude of the party determining the price be subject to a standard more definite than reasonableness or fairness.

D. Revision of price

28. When multiple shipments are spread out over a period of time, there may be a need to revise the price in order to reflect changes in the underlying economic conditions. It may be agreed that a revision would occur at specified points of time. Those points of time should be coordinated with the schedule for the fulfilment of the countertrade commitment (e.g., the revision is to take place four weeks prior to the commencement of a subperiod).

29. Under another approach, it may be agreed that a revision would take place in response to specified changes in underlying economic conditions (e.g., an exchange rate fluctuation beyond a certain percentage from a reference rate in effect on the date the countertrade agreement was concluded or changes beyond an agreed threshold in specified components of production cost such as raw materials or labour). Contractual provisions concerning price revision due to a change in the value of the currency in which the price is to be paid are mandatorily regulated under some legal systems. The parties should, therefore, examine whether a clause which they intend to include in the countertrade agreement is permitted under the law of the country of each party.

30. Yet another approach is to provide for a price revision at regular intervals (e.g., every six months), as well as for unscheduled revisions in response to specified changes in underlying economic conditions. In order to limit the frequency of price revision, it could be agreed that an unscheduled review could not take place within a specified period of time following a review, or within a specified period of time preceding a scheduled review. Yet another approach would be to set the price revision procedure in motion upon the delivery of a specified portion of the total quantity of goods to be purchased.

31. The countertrade agreement might provide for the price revision clause to apply only in cases where its application would result in a revision exceeding a certain percentage of the price.

32. When the countertrade agreement contains a price revision clause, the parties may wish to specify the shipments to which the revised price is to apply. It may be agreed, for example, that the applicable price for a given shipment is the price in effect on the date the goods are ordered or on the date the letter of credit is issued.

1. Reapplication of price clause

33. The parties may stipulate in the countertrade agreement that the price is to be revised through the use of the same method as was employed to determine the initial price (standards (paragraphs 11 to 20), negotiation (paragraphs 21 and 24), determination of price by a third person (paragraphs 25 and 26) or determination of price by one party (paragraph 27)).

2. Index clause

34. The purpose of index clauses is to revise the price of the countertrade goods by linking the price to the levels of the prices of certain goods or services prevailing on a certain date. A change in the agreed indices automatically effects a change in the price. In formulating an index clause, it is advisable to use an algebraic formula to determine how changes in the specified indices are to be reflected in the price. Several indices, with different weightings given to each index, may be used in combination in the formula in order to reflect the proportion of different cost elements (e.g. materials or services) to the total cost of construction. Different indices may be contained in a single formula to reflect the costs of different types of materials and services. When the sources of the same cost element (e.g., labour or energy) are in different countries, different indices may be found in a single formula for that cost element.

35. Several factors may be relevant in deciding on the indices to be used. The indices should be readily available (e.g. they should be published at regular intervals). They should be reliable. Indices published by recognized bodies (such as well-established chambers of commerce), or governmental or inter-governmental agencies, may be selected. The parties should exercise caution in using indices based on different currencies in a formula, as changes in the relationships between the currencies may affect the operation of the formula in unintended ways.

36. In some countries, particularly in developing countries, the range of indices available for use in an index clause may be limited. If an index is not available for a particular element of costs, the parties may wish to use an available index in respect of another element. It is advisable to choose an element whose price is likely to fluctuate in approximately the same proportions and at the same times as the actual element to be used. For example, in cases where it is desired to provide an index for labour costs, a consumer price index or cost-of-living index is sometimes used if there is no wage index available.

3. Change in exchange rate of currency in which price is payable

(a) Currency clause

37. Under a currency clause, the price to be paid is linked to an exchange rate between the currency in which the price is to be paid and a certain other

currency (referred to as the "reference currency") determined at the time of entering into the countertrade agreement. If this rate of exchange has changed at the time of payment, the price to be paid is increased or decreased in such a way that the amount of the price in terms of the reference currency remains unchanged. For purposes of determining the applicable exchange rate, it may be desirable to adopt the time of actual payment, rather than the time when the payment falls due. If the latter time is adopted, the supplier may suffer a loss if the purchaser delays payment. Alternatively, the supplier may be given a choice between the exchange rate prevailing at the time when payment falls due or that prevailing at the time of actual payment. It is advisable to specify an exchange rate prevailing at a particular place.

38. The reference currency should be stable. The insecurity arising from the potential instability of a single reference currency may be reduced by reference to several currencies. The contract may determine an arithmetic average of the exchange rates between the currency in which the price is payable and several other specified currencies, and provide for revision of the price in accordance with changes in this average.

(b) Unit of account clause

39. If a unit-of-account clause is used, the price is denominated in a monetary unit of account composed of cumulative proportions of a number of selected currencies. In contrast to a clause in which several currencies are used (paragraph 38 above), the weighting given to each selected currency of which such a monetary unit of account is composed is usually not the same, and greater weight is given to currencies generally used in international trade. The unit of account may be one that is established by an intergovernmental institution or by agreement between two or more States and that specifies the selected currencies making up the unit and the relative weighting given to each currency (e.g., Special Drawing Right (SDR), European Currency Unit (ECU), or Unit of Account of the Preferential Trade Area for Eastern and Southern African States (UAPTA)). In choosing a unit of account, the parties should consider whether the relation between the currency in which the price is payable and the unit of account can be easily determined at the relevant times, i.e., at the time of entering into the supply contract and at the time of actual payment.

40. The value of a unit of account composed of a basket of currencies is relatively stable, since the weakness of one currency of which the unit of account is composed is usually balanced by the strength of another currency. The use of such a unit of account will therefore give substantial protection against changes in exchange rates of the currency in which the price is payable in relation to other currencies.

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Addendum

IX. PAYMENT

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A. General remarks

1. The parties may decide that the payment obligation under the supply contract in one direction is to be liquidated independently from the payment obligation under the supply contract in the other direction. When payments are independent, the payment under each supply contract is made in a way that is used in trade generally, such as payment on open account, payment against documents, or letters of credit. Alternatively, the parties may decide to link payment so that the proceeds generated by the contract in one direction would be used to pay for the contract in the other direction, thus allowing the transfer of funds between the parties to be avoided or reduced. The legal guide discusses only linked payment arrangements. It does not discuss independent payment arrangements since they do not raise issues specific to countertrade.

2. One reason the parties may have for linking payments is the expectation that it would be difficult for a party to effect payment in the agreed currency. Another reason may be to ensure that the proceeds generated by the shipment in one direction would be used to pay for the shipment in the other direction. Payment mechanisms designed to meet such needs include retention of funds by the importer (paragraphs 6 to 10 below), blocking funds paid under the export contract through blocked accounts or crossed letters of credit to secure their availability to pay for the counter-export contract (paragraphs 11 to 34 below), and setoff of countervailing claims for payment (paragraphs 35 to 52 below).

3. An aspect of linked payment mechanisms to be considered is the financing costs that result from the fact that linked payment mechanisms immobilize the proceeds of shipments made by the parties. The longer the interval between the time the proceeds are generated by the contract in one direction and the time those proceeds are used to pay for the contract in the other direction, the greater the financing costs are likely to be.

4. The parties may wish to consider the possibility of interference by a third party in the functioning of the linked payment mechanism. For example, a creditor of one of the countertrade parties may seize proceeds of a supply contract or a payment claim of the debtor, the bank holding the funds may become insolvent or governmental authorities may intervene to prevent payment due to shortage of foreign exchange. Such interference could result in the freezing of the payment mechanism until the claim against the countertrade party is adjudicated or a governmental measure lifted. A factor in assessing this risk is the degree of protection the law applicable to the payment mechanism affords against third-party interference. Furthermore, the longer funds are held in the payment mechanism, or claims for payment wait to be set off, the greater the risk of third-party interference.

5. It should be noted that payment mechanisms may require governmental authorization if they involve a delay in or an absence of repatriation of the proceeds of a supply contract, the holding of funds abroad or the holding of a domestic account in a foreign currency.

B. Retention of funds by importer

6. Sometimes it is agreed that the shipment in a particular direction (export contract) is to precede the shipment in the other direction (counter-export contract), and that the proceeds of the export contract are to be used to pay for the subsequent counter-export. Such cases are sometimes referred to as "advance purchase" in view of the fact that the importer is to purchase goods in advance in order to generate financing for the counter-export contract. In such cases, the parties may agree that the proceeds of the export contract will be held under the control of the importer until payment under the counter-export contract becomes due.

7. A consideration as to the acceptability of such an arrangement would be the exporter's confidence that the importer will hold the funds in accordance with the countertrade agreement. Such confidence is more likely to exist when the parties have an established relationship. Another consideration is the risk that the importer will become insolvent or that the funds in the hands of the importer will be subject to a third-party claim. Under ordinary circumstances the claim of the exporter would have no priority over that of another creditor of the importer. In some legal systems, the funds may enjoy a degree of protection against the claims of third parties if the agreement concerning the retention of funds places the importer in a fiduciary position with respect to the funds. For example, in common law systems, this might be done by establishing a "trust" in which the importer acts as the "trustee" of the funds. Fiduciary mechanisms available in some other legal systems may offer similar protection.

8. Furthermore, if the countertrade agreement does not specify the type of goods to be counter-exported, or if no standard exists to measure the quality of the type of goods agreed upon, a disagreement may arise over the type, quality or price of counter-export goods. The possibility of such a disagreement increases the risk that for an unacceptable period of time the retained funds will neither be put to the intended use nor released to the exporter. When the parties are able to specify the type of goods, a consideration affecting the acceptability of retention of funds by the importer may be the length of time required to make the counter-export goods

available. Retention of funds by the importer might be more acceptable when the goods to be purchased with the retained funds are available in stock and can be shipped quickly, and less acceptable when the goods have to be specially manufactured.

9. An appropriate balance needs to be established between two opposing objectives. One objective is to assure the exporter access to the funds if the counter-export did not take place. The other objective is to assure the importer that the funds will not be transferred to the exporter, at least not the full amount, if the exporter is in breach of the commitment under the countertrade agreement to counter-import. The first objective may be advanced by fixing a date by which the funds have to be transferred to the exporter in the event the counter-export has not taken place. The second objective may be advanced by authorizing the importer to deduct any liquidated damages or penalty that may be due to the importer for the exporter's breach of the countertrade commitment before the funds are returned to the exporter.

10. Depending upon the length of time the funds are to be retained under the control of the importer, the parties may wish to consider providing in the countertrade agreement for the payment of interest. If they do so, the parties may stipulate the manner in which the funds are to be deposited so as to earn the most favourable rate of interest.

C. Blocking of funds

1. General remarks

11. When the exporter does not wish to leave the funds generated by the export contract under the control of the importer, the parties may wish to use another payment mechanism designed to ensure that the proceeds of the first shipment are used for the intended purpose. The legal guide addresses two mechanisms of this type, blocked accounts and crossed letters of credit.

12. When the parties opt for a blocked account, they agree that the importer's payment is to be deposited in an account at a financial institution agreed upon by the parties and that the use and release of the money will be subject to certain conditions. After the funds have been deposited in the account, the importer counter-exports and obtains payment from those funds by presentation of agreed upon documentation evidencing the performance of the counter-export contract to the institution administering the account. Accounts of this nature have been referred to as "escrow", "trust", "special", "fiduciary" or "blocked" accounts. The expression "blocked account" is used here in order to avoid unintended references to particular varieties of such accounts that may be encountered in different legal systems.

13. When the parties opt for crossed letters of credit, the importer opens a letter of credit to cover payment for the export contract ("export letter of credit"). The export letter of credit then serves as the basis for the issuance of a letter of credit to pay for the counter-export contract ("counter-export letter of credit"). Pursuant to the instructions of the parties, the proceeds of the export letter of credit are blocked in order to cover the counter-export letter of credit. The export letter of credit is liquidated when the exporter presents the required documents, including an irrevocable instruction that the proceeds should be used to cover payment

under the counter-export letter of credit. Payment under the counter-export letter of credit, which is funded by the export letter of credit, is effected upon presentation of the required documents by the counter-exporter.

14. A blocked account or crossed letters of credit may be used when the importer does not wish to ship the counter-export goods until the availability of funds to pay for those goods is secured. In such "advance purchase" arrangements, both blocked accounts and crossed letters of credit provide security that the funds generated by the shipment in one direction, specifically designated to occur first, would be used to pay for the subsequent shipment in the other direction.

15. The financial drawbacks of blocking funds may be mitigated to some degree if interest accrues on the blocked funds. A bank holding funds designated for paying letters of credit may be less inclined to pay interest than a bank holding funds in a blocked account. For this reason, a blocked account may provide an interest-bearing vehicle for holding excess funds in anticipation of future orders. This may be helpful in cases where the parties are not certain at the outset as to whether all the proceeds generated by the export will be needed to pay for the counter-export.

2. Blocked accounts

16. Some legal systems provide special legal regimes for blocked accounts if they are established in a particular legal form (e.g., "trust" account or "compte fiduciaire"). In those legal systems, a blocked account would be subject to general contract law if it is not established in such a particular form. When a special legal regime is applicable, the holder of the funds is subject to special fiduciary obligations with respect to the disposition of the funds and the funds may enjoy a degree of protection against seizure by third-party creditors.

17. Contractual provisions outlining the agreement of the parties on the blocked account will be found in the countertrade agreement. In addition, an agreement will have to be concluded between the bank and one or more of the countertrade parties ("blocked account agreement", paragraphs 23 to 27 below). The provisions in the supply contracts concerning the blocked account will normally be limited to identifying the account to be used for payment.

(a) Countertrade agreement

(i) Location of account

18. The parties should consider stipulating in the countertrade agreement the location of the account. They may do so by identifying the bank, indicating the country in which the account is to be opened or providing some other criterion for selection of the bank. The choice of possible locations of the account may be limited if the legal system of the party whose shipment generated the funds restricts the right to hold currency abroad. In such a case the choice may be limited to establishing the account with a bank located in that party's country.

19. When the parties have a choice as to the location of the bank, they should bear in mind that the location of the account may determine the law applicable to the account. The suitability of the applicable law in a given

location may be assessed in view of the security provided to the parties that the fiduciary obligations of the bank will be properly exercised. Furthermore, it is desirable that the applicable legal regime provide some protection against interference by a third-party creditor of one of the parties. As noted in paragraph 16 above, a degree of protection may be available under some legal systems against claims of third persons.

(ii) Operation of blocked account

20. It is advisable that the countertrade agreement contain certain basic provisions to be incorporated in the blocked account agreement with the bank. Such provisions enable each party, upon agreeing to the use of a blocked account, to establish that the account will have the features it considers important. These provisions concern, in particular, procedures for the transfer of funds into the account, documentary requirements for transfer of funds out of the account (e.g., payment request using a prescribed form, bill of lading or other shipping document, certificate of quality) and interest. In addressing the contents of the blocked account agreement in the countertrade agreement, the parties should be aware that the bank is likely to be accustomed to handling blocked accounts on the basis of contract forms or standard conditions.

21. The countertrade agreement may provide that payments into the account would be made through a letter of credit opened by the importer in favour of the exporter. It may also be agreed that disbursement of the funds held in the account would be carried out through a letter of credit opened by the counter-importer in favour of the counter-exporter. In such cases it is advisable that the countertrade agreement specify the instructions to be given to the issuing banks and the documents to be presented under the letters of credit. For example, the beneficary would be required to present, along with documents evidencing shipment, an irrevocable instruction that the proceeds should be deposited in the blocked account.

(iii) Other issues

22. It is advisable that the countertrade agreement address issues such as amount of funds to be blocked, interest, transfer of unused or excess funds, and any supplementary payments (for a discussion of various issues common to linked payment mechanisms that might be dealt with in the countertrade agreement, see paragraphs 53 to 60 below).

(b) Blocked account agreement

23. The blocked account agreement would contain instructions to the bank and specify the actions to be taken by the trading parties and the bank, as well as other provisions concerning the operation of the blocked account. The blocked account agreement would also address issues such as interest and bank charges. It is important to ensure that the blocked account agreement is consistent with the provisions in the countertrade agreement concerning the blocked account.

(i) Parties

24. The blocked account agreement will be concluded between the bank holding the account and one or more of the countertrade parties. In some

cases, an additional bank may be a signatory to the blocked account agreement. That may occur where the funds to be paid into the account are to be channelled, by agreement or by mandatory law, through a particular bank. Some legal systems require that a blocked account established abroad be held in the name of its central bank and that that bank be a party to the blocked account agreement. In multi-party countertrade situations where the counter-exporter or counter-importer are distinct from the exporter and importer, the additional trading parties may also be parties to the blocked account agreement.

(ii) Transfer of funds into and out of account

25. The blocked account agreement would set out procedures customarily used by the bank in administering a blocked account. It is advisable that the parties make sure that their agreement as to the manner in which the funds are to be paid into the account and disbursed from the account to the counter-exporter (see paragraphs 20 and 21 above) is reflected in the blocked account agreement. It may be useful to indicate whether partial drawings are permitted, the manner in which the amount to be paid is to be determined (e.g., on the basis of the face value of the invoice) and whether notification of payment requests would be made to the party that deposited funds in the account. The blocked account agreement would also describe the conditions under which excess or unused funds should be transferred to the exporter, or applied according to his instructions (see paragraphs 57 and 58 below). In the latter case, the blocked account agreement may indicate the terms on which funds would be held before instructions are received from the exporter.

26. It should be noted that the bank holding the blocked funds may require that its responsibility be limited to examining the conformity of the documents included in the counter-exporter's request for payment with the agreed upon requirements, rather than ascertaining whether the underlying contract has been performed. The bank may also require that the counter-exporter, who will be paid from the account, indemnify the bank against costs, claims, expenses (other than normal administrative and operating expenses) and liabilities which the bank may incur in connection with the blocked account.

(iii) Duration and closing of account

27. In order to ensure the availability of the blocked account for the necessary period of time, the blocked agreement should specify that the account will remain open until a certain date or for a period of time following the entry into force of the countertrade agreement. The parties may wish to provide that the blocked account would remain operative for a period of time (e.g., 60 days) following the end of the period for the fulfilment of the countertrade commitment. Such a time period would enable the transaction to be completed as planned in the event that shipment under the counter-export contract took place just before expiry of the fulfilment period or was delayed for justified reasons. The blocked account agreement could indicate circumstances in which the account would close, in addition to the passage of an agreed upon period of time. These could include an event such as rescission of the export contract or of the countertrade agreement.

3. Crossed letters of credit

28. Where the parties wish to block funds using crossed letters of credit, it is advisable that the countertrade agreement include provisions concerning the designation of the participating banks (see paragraph 54 below), the instructions to be given to the participating banks for the issuance of the export letter of credit and the counter-export letter of credit and for the allocation of their proceeds, and the documents to be presented in order to obtain payment. In addition, the parties would have to stipulate that the shipment and presentation of documents in one direction should precede the shipment and presentation of documents in the other direction.

(a) Sequence of issuance

29. The parties may agree that the counter-export letter of credit should be issued prior to the issuance of the export letter of credit. Such a sequence of issuance may be an important consideration to a counter-exporter whose motive to conclude the import contract was the expectation of being able to counter-export. The failure to issue the counter-export letter of credit, and the resultant absence of a counter-export, may leave the importer liable for costs associated with the import that the importer had originally intended to cover by the proceeds of the counter-export (e.g., commission to a third person for resale of goods purchased under the export contract). In order to protect the interest of the exporter who agrees to open the counter-export letter of credit before the export letter of credit is issued, the parties may agree that payment under the counter-export letter of credit will require documentary proof of the issuance of the export letter of credit.

30. In some cases the parties may decide to open the counter-export letter of credit only when the proceeds of the export letter of credit would be available to cover the counter-export letter of credit. In order to address the risk that the export letter of credit is opened without the counter-export letter of credit being subsequently issued, the parties may wish to include an appropriate liquidated damages or penalty provision in the countertrade agreement.

(b) Instructions for allocation of proceeds

31. The instructions from the importer for the issuance of the export letter of credit should provide that the documents required to be presented to obtain payment include irrevocable instructions from the exporter that the proceeds of the export letter of credit should be used to pay for the counter-export letter of credit upon presentation of the shipping documents relating to the counter-export. The instructions for issuance of the counter-export letter of credit should indicate that payment is to be made using the proceeds of the export letter of credit.

32. The choice as to the form of payment is limited to payment at sight or payment on a deferred basis. The other option used in practice to delay payment of a letter of credit, payment by acceptance of a draft, is incompatible with the linked payment objective of the crossed letters of credit. If the draft were transferred to a third person, the issuer of the export letter of credit would normally be obligated to pay the holder (and the importer would be obligated to reimburse the issuing bank) independently of the crossed letter of credit payment scheme and the performance of the

counter-export. If the export letter of credit is payable at sight, the issuing bank is given an irrevocable instruction to retain the funds until a given date for the purpose of paying the counter-export letter of credit. If the export letter of credit is a deferred-payment letter of credit, the bank issuing the export letter of credit would be instructed that, upon the date payment is due, the funds are to be used for payment under the counter-export letter of credit.

33. It is advisable that the instructions for the issuance of the export letter of credit stipulate that the proceeds of the export letter of credit would be paid to the exporter in the event the counter-export fails to materialize. Under an export letter of credit payable at sight, the proceeds would be paid to the exporter if by an agreed date the counter-export goods have not been shipped. If the export letter of credit is payable on a deferred basis, it could be provided that the proceeds will be paid to the exporter if, by the payment date, the counter-exporter has not presented the required documents. Payment to the exporter would also be in order when the proceeds of the export letter of credit exceed what is needed to cover the counter-export letter of credit. If such a situation is foreseen, it is advisable that the importer instruct the issuer of the export letter of credit to transfer to the exporter any proceeds of that letter of credit that are in excess of the specified amount needed to cover the counter-export letter of credit.

(c) Expiry dates

34. It is advisable that the counter-export letter of credit expire a reasonable period of time after the expiry of the export letter of credit. Where the two letters of credit have an identical or almost identical expiry date, insufficient time may remain for shipment and presentation of documents under the counter-export contract if shipment and presentation of documents under the export contract took place at the last minute.

D. Setoff of countervailing claims for payment

1. General remarks

35. The parties may agree that their mutual claims for payment based on shipments made in each direction would be set off. Under such an arrangement, each party is compensated for its deliveries through deliveries of goods from the other party. Money is not actually paid except to settle an imbalance in the values of the shipments in the two directions.

36. A setoff approach may be utilized when only one shipment is to be made in each direction or when multiple shipments are to be made in the two directions over a longer period of time. The present section discusses the record-keeping mechanism that the parties may wish to use to set off payment claims of multiple shipments. Such a record-keeping mechanism, referred to in the legal guide as a "setoff account", is referred to in practice by various terms, including "compensation account", "settlement account" or "trade account".

37. A setoff account may be administered by the parties themselves or by a bank. The engagement of a bank may be prescribed by mandatory rules of law.

Banks are also used because the parties may wish that the debit and credit entries in the setoff account be made on the basis of shipping documents examined in accordance with procedures customarily used by banks. Furthermore, banks engaged to administer a setoff account may agree to guarantee the obligation of a countertrade party to liquidate an imbalance in the flow of trade.

38. Under one approach to structuring a setoff account, two accounts are maintained for recording debit and credit entries, one at a bank in the country of one party and another one at a bank in the country of the other party. Another approach would be to use a single account administered by a single bank; other banks may be involved for the purpose of forwarding documents and issuing or advising letters of credit.

39. When two banks are involved in administering the setoff arrangement, it is probable that they will conclude an interbank agreement. This interbank agreement may cover some of the points already addressed in the countertrade agreement, as well as establish the technical arrangements relating to the setoff account. The countertrade agreement may refer to the interbank agreement, stating that the technical details of the operation of the accounts will be in accordance with an interbank agreement concluded between the participating banks. Although the countertrade parties are not normally signatories to an interbank agreement, it is advisable that the countertrade parties participate in the preparation of the interbank agreement in order to ensure consistency between the countertrade agreement and the interbank agreement (interbank agreements are discussed in paragraphs 55 and 56 below).

40. The legal guide does not address State-to-State umbrella agreements for mutual trade within the framework of a clearing account between governmental banking authorities. Under such arrangements the value of deliveries in the two directions is recorded in a currency or unit of account and eventually set off between the governmental banking authorities. Individual traders in each country conclude contracts directly with each other but submit their claims for payment to their respective central or foreign trade bank and receive payment in local currency. Similarly, purchasers pay their respective central or foreign trade bank in local currency for their imports. Such clearing mechanisms, which might be part of economic measures designed to promote trade, fall outside the ambit of the legal guide since the individual supply contracts in one direction concluded under the umbrella agreement are not contractually linked to contracts concluded in the other direction.

2. Countertrade agreement

(a) Effecting credit and debit entries

41. The parties may wish to agree that entries in the account will be made on the basis of documents. The countertrade agreement should stipulate the documents required to be presented by the supplier in order to obtain a credit. The type of documents stipulated depends on the point of time in the execution of a supply contract at which the parties wish to allow credit to be given to the supplier. These documents might include, for example, invoices, packing lists, certificates of quality or quantity, bills of lading or other transport documents, evidence of the customs clearance of the goods in the receiving country or of their acceptance by the purchaser, and any other

documents stipulated under the individual supply contracts. The parties may also wish to agree on the contents of any statement which the supplier would be required to make concerning the transaction being credited (e.g., purchase order number, date of shipment, description of the type, quantity and value of the goods, number and weight of the packages, particulars concerning carriage, and reference to the setoff account.)

42. Where it is agreed that entries in the account are to be made on the basis of events occurring in the country of destination (e.g., customs clearance or acceptance by the purchaser), the parties may wish to maintain a parallel record of shipments already in transit, but not yet cleared by customs or accepted by the purchaser. Such a parallel mechanism would provide an indication of the upcoming claims for payment that would be entered in the account once goods in transit have cleared customs or have been accepted by the purchaser. This information would enable the parties to apply certain provisions of the setoff mechanism (e.g., limits on outstanding balance, paragraph 49 below, and settlement of imbalance, paragraphs 50 and 51 below) with greater flexibility than might otherwise be the case. For example, the parties may agree that the application of a balance limit to a party in a debit position could be suspended if the value of goods in transit were to be taken into consideration. This would permit a party who would otherwise be barred from receiving additional shipments of goods to continue receiving goods.

43. In a setoff arrangement comprised of a single account, the parties may agree that the presentation of the agreed documents to the administering bank triggers the appropriate debiting or crediting action. A setoff arrangement comprised of two accounts could operate as follows: the purchaser, through its bank, submits to the supplier's bank a copy of a purchase order, and any other documents stipulated in the countertrade agreement or specified in the purchase order. On receipt of the required documents, the supplier's bank debits the purchaser's account. Upon passing the debit entry, the supplier's bank forwards the documents to the purchaser's bank, along with a statement concerning the effective date of the debit entry. The effective date of the debit entry, as agreed upon in the interbank agreement, may be, for example, the date when the documents are dispatched by the supplier's bank to the purchaser's bank. Upon receipt of the documents, the purchaser's bank makes in its books a corresponding credit entry in the supplier's account.

44. Because a setoff account is used for recording the values of shipments rather than for making payments, the use of letters of credit is not necessary. When letters of credit are used, they are used in order to apply established procedures for examination of shipping documents rather than for transferring money. In such cases, the countertrade agreement, in addition to stipulating the instructions to be given to the issuing banks, may provide that letters of credit be subject to the Uniform Customs and Practice for Documentary Credits (1983 Revision, Publication 400 of the International Chamber of Commerce).

(b) Calculation of entries

45. The countertrade agreement should indicate the currency or unit of account in which the values of the deliveries are to be expressed (paragraph 53 below). In addition, the parties may wish to address the question whether interest calculated on the amount of an imbalance would be registered in the

setoff account. Furthermore, the parties may wish to stipulate whether debit and credit entries can be made only on the basis of the required documents evidencing shipment or also on the basis of any claims arising from defective goods or delayed shipment. If debit and credit entries are made only on the basis of shipping documents, claims relating to defective performance of supply contracts would be settled apart from the setoff mechanism. If, however, the parties agree that claims based on defective performance of supply contracts would affect the balance of the setoff account, it is advisable to stipulate the types of documents that would have to be presented in order to alter the balance of the setoff account. For example, the countertrade agreement could require an arbitral award, or a statement by the defaulting party, indicating the amount involved.

46. In order to protect the setoff mechanism against uncertainty that may result from taxation, the parties and the banks may agree that taxes will be paid separately. Such a provision is intended to facilitate the trade balancing aim of the clearing mechanism by allowing the full value of a given shipment to be credited.

(c) Statements of account

47. An issue relevant to setoff accounts is the manner in which the participating bank or banks will be expected to furnish reports on the status of the setoff account to each other or to the trading parties. The agreement of the parties on this issue in the countertrade agreement is particularly relevant where one bank maintains the account on behalf of both parties. Where two banks are involved, the question of reporting may be covered in the interbank agreement. Issues to be agreed upon include the frequency, timing and contents of the reports, procedure for objections and period of time within which objections must be made before a report is deemed accepted.

(d) Periodic verification

48. In order to minimize the possibility of errors or discrepancies in the setoff account, the parties may agree to verify the recorded value of shipments in the two directions at fixed points of time. The determination of the outstanding balance can be based, for example, on the preceding statement of account that has been accepted and the subsequent debit and credit entries advised in the agreed upon manner. The parties may wish to be specific as to the length of time within which the checking procedure must be completed (e.g., within seven days of the fixed points of time).

(e) Limits on outstanding balance

49. The parties may agree that at any point in time during the course of the setoff arrangement a credit or debit balance in the setoff account with respect to either party would not exceed an agreed upon balance limit. In accordance with such a balance limit (sometimes referred to as a "swing"), debit and credit entries would not be entered in excess of the balance limit. It could also be provided that shipments of goods would be suspended to a party whose acceptance of goods without shipping a sufficient quantity in return had resulted in a debit balance reaching the agreed upon limit. Shipments to that party, and the corresponding debit entries, would resume once the debit balance had been brought within the permissible range.

(f) Settlement of imbalance

50. It is advisable that the parties agree in the countertrade agreement on the manner in which imbalances in the flow of trade that remain at the conclusion of the fulfilment period, or at the conclusion of subperiods of the fulfilment period, are to be settled. With respect to imbalances remaining at the conclusion of subperiods, it may be agreed that an imbalance up to a certain limit would be added to the obligation of a party in the next subperiod. Any remaining amount that exceeded the limit and was not permitted to be carried forward to the next subperiod would have to be settled by cash or deliveries of goods within a specified shorter period of time. The purpose of limiting the amount of imbalance that can be carried forward is to reduce the risk of an imbalance developing that would be difficult to rectify by the conclusion of the fulfilment period.

51. It may be agreed that an imbalance remaining at the conclusion of the fulfilment period is to be liquidated by a currency transfer within an agreed period of time. Alternatively, the parties may agree upon settlement by supplementary exports to be carried out within a fixed period of time, with any imbalance still remaining after the conclusion of the supplementary period to be settled by a currency transfer within an agreed period of time.

(g) Guarantee for payment of outstanding balance

52. In a setoff arrangement involving two banks, each bank may guarantee the obligation to liquidate any outstanding imbalance. Where a single account is maintained by one bank on behalf of both parties, a guarantee covering liquidation of an imbalance can be maintained by that bank in favour of whichever of the parties has the outstanding credit balance. The parties may agree that the costs of maintaining such a guarantee be apportioned between them. The amount of a guarantee for payment of outstanding balance is normally limited to the permitted balance limits under the setoff arrangement. (For further discussion of such guarantees, see chapter XII, "Security for performance", paragraphs 38 to 45.) Parties should be aware that there may be cases, however, where remittance of sums claimed under such guarantees would be subject to prior scrutiny and authorization of exchange control authorities. Sometimes it is possible to obtain prior authorization from exchange control authorities for the remittance of the payment under the guarantee.

E. Issues common to linked payment mechanisms

1. Currency or unit of account

53. The parties should designate the currency or unit of account in which the payment mechanism will operate. A factor of particular importance is stability in exchange rates of the chosen currency. Because of this consideration, the parties may wish to consider using a unit of account (e.g., SDR (Special Drawing Right), ECU (European Currency Unit) or UAPTA (Unit of Account of the Preferential Trade Area for Eastern and Southern African States)). Another factor in choosing a currency is that it be one in which the goods to be traded are typically valued. In setoff accounts, the currency in which the account operates takes on the character of a unit of account because payments are not made in setoff accounts except to liquidate

imbalances in trade. The parties may therefore denominate a setoff account in a currency that they would not use if payments actually had to be made for each shipment.

2. Designation of banks

54. The parties may wish to designate in the countertrade agreement the bank or banks they intend to use to administer the payment mechanism and issue any related letters of credit. When the parties do not designate a bank in the countertrade agreement, they may wish to agree, for example, that the bank would have to have its place of business in a particular country, that the bank must be acceptable to both parties or that the bank selected must be agreeable to an interest-bearing payment mechanism.

3. Interbank agreement

55. Where a bank is involved on each side of the countertrade transaction, the participating banks may conclude an interbank agreement concerning technical and procedural aspects of the payment mechanism. The interbank agreement would cover issues such as: statements of account; procedures for notification of interest due; how often interest is to be recorded; interbank communications for the purpose of advising debit and credit entries and transmission of documents; procedures for verification of entries in accounts; banking charges; and modification and assignment of the interbank agreement. Though the countertrade parties are not normally parties to the interbank agreement, they have an interest in the contents of the interbank agreement in view of its role in structuring the payment arrangement. It is therefore advisable that the countertrade parties consult with their banks to ensure that the terms of the interbank agreement are consistent with the terms of the countertrade agreement concerning payment.

56. The entry into force and duration of the interbank agreement may be linked to the entry into force and duration of the countertrade agreement in order to ensure the availability of the payment mechanism at the time the countertrade transaction is to be carried out. It is desirable to provide for the interbank arrangement to continue beyond the expiry or termination of the countertrade agreement for the purpose of settling any outstanding balance. In order to provide the trading parties an opportunity to approve the interbank agreement, the countertrade parties and participating banks might agree that the interbank agreement will enter into force upon the approval by the countertrade parties. In some countries the interbank agreement may require approval of exchange control or other governmental authorities.

4. Transfer of unused or excess funds

57. It is advisable that the parties provide for payment to the exporter of the proceeds of the export contract, or application of the proceeds according to the exporter's instructions, in the event that the counter-export does not take place by the agreed date. In order to address the concern of the importer about an arbitrary non-fulfilment of the countertrade commitment, it may be agreed that an amount equivalent to the sum that may be due from the exporter as damages, liquidated damages or penalty for breach of the countertrade commitment would be retained or transferred to a third party pending the resolution of a dispute as to responsibility for the non-fulfilment of the countertrade commitment.

58. A similar provision may be included with respect to funds generated by the export that are in excess of the amount needed to cover the price of the counter-export contract. Transfer of unused funds is also an issue when the parties agree that only a portion of the proceeds of the export contract is to be retained (e.g., as a deposit towards payment for the counter-export), and that the balance due under the counter-export will be paid at the time it becomes due.

5. Supplementary payments or deliveries

59. The parties may anticipate that their shipments will not be of the same value or in the planned quantity so that the proceeds of the shipment in one direction will be insufficient to cover payment for the shipment in the other direction. In such cases, it is advisable to agree whether the difference would be settled through additional deliveries or through cash payments.

6. Bank commissions and charges

60. It would be advisable for the parties to address in the countertrade agreement the question of payment of banking charges for operation of the payment mechanism, including the cost of any related letters of credit. In order to simplify the operation of the payment arrangement, it may be agreed that banking commissions and charges will be recorded separately from entries pertaining to shipment of goods. Where a single bank is used which acts on behalf of both parties, it may be agreed that the banking charges will be shared equally. Where a bank is involved on both sides of the transaction, it may be agreed that the charges of each bank will be paid by its respective client. According to an alternative method of apportioning costs for letters of credit, charges for the issuance of a letter of credit are borne by the purchaser, while charges for negotiation and confirmation, if required, are borne by the supplier. Extensions or other amendments of letters of credit could be borne by the party responsible for such extension or amendment.

F. Payment aspects of multi-party countertrade transactions

1. General remarks

61. A countertrade transaction may involve one or more third parties. In some cases, in addition to the exporter and the importer, a third-party counter-importer is involved ("three-party countertrade"); in other cases, in addition to the exporter and the importer, a third-party counter-exporter is involved ("three-party countertrade"); in yet other cases, in addition to the exporter and the importer, both a third-party counter-importer and a third-party counter-exporter are involved ("four-party countertrade") (see chapter VIII, "Participation of third persons", paragraphs ____ to ____). The engagement of a third-party counter-importer may occur when the importer needs to sell goods in order to secure funds to cover the cost of the import, but the exporter is not interested in purchasing or is not able to purchase what the importer has to sell. A third-party counter-exporter may be engaged when the importer itself does not have goods of interest to the exporter.

62. If the parties agree that the payment obligations under the export contract and under the counter-export contract are to be settled

independently, a countertrade transaction involving third parties does not raise payment issues specific to countertrade. Issues specific to countertrade are raised if the proceeds of the contract between one pair of parties (e.g., importer and exporter) will be used to pay for a contract between a different pair of parties (e.g., importer and third-party counter-importer). In such cases, as described in the following two paragraphs, a party receiving goods does not pay or ship to the party supplying those goods, but instead pays or ships to a third party.

63. In a three-party countertrade transaction involving a third-party counter-importer, the importer, instead of transferring money to the exporter under the export contract, delivers goods to the counter-importer and is considered to have discharged the payment obligation for the import up to the value of countertrade goods delivered to the counter-importer. The counter-importer, in turn, pays the exporter an amount equivalent to the value of the goods received from the counter-exporter. Similarly, in a three-party transaction involving a third-party counter-exporter, the importer transfers funds to the counter-exporter to pay for the shipment to the counter-importer and the counter-importer (exporter) agrees that the claim for payment under the export contract is discharged by the value of the goods that have been counter-exported to him.

64. In a four-party countertrade transaction, where the counter-exporter is a separate party from the importer and the counter-importer is a separate party from the exporter, the exporter ships goods to the importer and the importer, instead of paying the exporter, pays to the counter-exporter an amount equivalent to the value of the goods received from the exporter. The payment from the importer to the counter-exporter compensates the counter-exporter for the shipment to the counter-importer. The counter-importer pays to the exporter an amount equivalent to the value of the goods received from the counter-exporter.

65. Payment in a multi-party countertrade transaction may be structured so that cross-border payment would not be necessary. This would be possible, as between an importer and an exporter, when the importer and the third-party counter-exporter are located in the same country or when the exporter and a third-party counter-importer are located in the same country. When both the counter-exporter and the counter-importer are third parties, cross-border payments may be avoided if both the exporter and the counter-importer are both located in one country and if the importer and the counter-exporter are both located in another country. Where cross border transfer of currency does not take place, payments would be made in local currency between parties on each side of the transaction.

66. In multi-party countertrade, in addition to the payment-related provisions in the countertrade agreement and the export and counter-export contracts, there would also be agreements between the exporter and the counter-importer or between the importer and the counter-exporter concerning payment in local currrency equivalent to the value of the goods received by a given party and the payment of a commission. Furthermore, an agreement may be concluded between the participating banks concerning the payment mechanism.

67. The countertrade agreement should describe the performance for which each party is responsible, the sequence in which shipments are to take place, the manner and sequence of payments, and the instructions to be given to the

participating banks. A multi-party countertrade transaction with a linked payment mechanism requires coordination of the actions of the participating parties and of the instructions given to the participating banks. It is advisable to have a single countertrade agreement, signed by all the participating parties. Where not all the parties to a multi-party transaction are parties to the countertrade agreement, it may be necessary to include in the individual supply contracts terms concerning the linked payment mechanisms.

2. Blocking of funds in multi-party countertrade

68. As in countertrade involving two parties, blocked accounts and crossed letters of credit may be used in multi-party countertrade. Issues relevant to the use of blocked accounts and crossed letters of credit are discussed in paragraphs 11 to 34 above.

69. When a blocked account is used in a four-party transaction, or in a three-party transaction involving a third-party counter-exporter, the proceeds of the export contract would be held in a blocked account until presentation of documents evidencing performance of the counter-export contract, at which point the funds would be transferred to the counter-exporter. In the event that, by the deadline for presentation of documents evidencing performance of the counter-export contract, those documents have not been presented, the funds would be transferred to the exporter. In order to establish payment through a blocked account, the exporter and importer conclude a blocked account agreement with the bank selected to administer the account.

70. When crossed letters of credit are used in a three-party transaction involving a third-party counter-exporter, the counter-importer (exporter) opens a letter of credit in favour of the counter-exporter (counter-export letter of credit). Cover for the counter-export letter of credit is obtained from the proceeds of the letter of credit opened by the importer for the benefit of the exporter (export letter of credit). The exporter obtains access to the shipping documents relating to the counter-export goods by presenting evidence of shipment under the export contract and an instruction that the proceeds of the export letter of credit should be used to cover the counter-export letter of credit. Similarly, in the case of a three-party transaction involving a third-party counter-importer, the proceeds of the export letter of credit could be used to cover the counter-export letter of credit.

71. When crossed letters of credit are used in a four-party transaction, the importer, who obtains the issuance of the export letter of credit, deposits with the issuing bank of the export letter of credit the amount of that letter of credit. Upon the instruction of the exporter, the proceeds of the export letter of credit are not paid to the exporter, but are blocked to cover the counter-export letter of credit. Upon the presentation by the counter-exporter of shipping documents under the counter-export letter of credit, the funds deposited by the importer to cover issuance of the export letter of credit are paid to the counter-exporter; on the other side of the transaction, the counter-importer pays the exporter an amount equivalent to the value of the goods received by the counter-importer. If the counter-exporter does not present shipping documents under the counter-export letter of credit, the funds deposited by the importer to cover the export letter of credit would be transferred to the exporter.

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INTERNATIONAL COUNTERTRADE

Draft legal guide on drawing up contracts in international countertrade transactions: sample chapters*

Report of the Secretary-General

Addendum

XII. SECURITY FOR PERFORMANCE

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*The draft chapter contained herein has been prepared by the Secretariat for consideration by the Commission as part of the preparatory work on the draft legal guide on drawing up contracts in international countertrade transactions and should not be regarded as stating the views of the Commission.

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A. General remarks

1. The legal guide focuses on guarantees (also referred to in practice as "bonds" or "indemnities") in a countertrade transaction supporting the countertrade commitment. Such a guarantee may support the obligation of the party committed to purchase countertrade goods, as well as the obligation of the party committed to supply goods. Sometimes a guarantee supports the countertrade commitment by way of securing payment under a liquidated damages or penalty clause covering the countertrade commitment. Guarantees particular to countertrade may also be used to support liquidation of imbalances in the flow of trade (paragraphs 38 to 45 below). Guarantees supporting the performance of individual supply contracts are not specifically addressed since they do not raise issues particular to countertrade.

2. Requiring guarantees may have the general advantage of preventing parties who are unreliable or who do not have sufficient financial resources from participating in the countertrade transaction. Guarantor institutions generally make careful inquiries about a party whose obligations they are asked to guarantee, and will normally provide guarantees only when they have reasonable ground for believing that the party can successfully perform the obligation. This may be of particular advantage to importers or exporters who are otherwise unable to determine whether the proposed counter-party is reliable.

3. Depending upon its terms, a guarantee may be independent of, or accessory to, the underlying obligation. Under an independent guarantee, the guarantor's obligation to pay does not depend on whether the obligated party (the "principal"), who procures the guarantee, has in fact breached the underlying obligation, but on whether the party to whom the obligation is owed (the "beneficiary") has complied with the payment conditions of the guarantee (for a discussion of payment conditions, see paragraphs 15 to 20 below). Upon meeting the payment conditions, the beneficiary receives prompt payment even if there is disagreement between the principal and the beneficiary as to whether the underlying obligation has been breached. It would be up to the principal, in an action for recovery of the amount paid, to prove that the obligation had not been breached. Despite the fact that a guarantor's obligation to pay may be independent from the underlying obligation, the right of the beneficiary to claim under the guarantee may under the law applicable to the guarantee be excluded in exceptional circumstances, in particular when the claim by the beneficiary is fraudulent.

4. Under an accessory guarantee, the guarantor must pay only when the principal is in fact in breach of the guaranteed obligation. Such accessory guarantees are referred to in national laws by terms such as "suretyship", "cautionnement", "garantía", and "Bürgschaft". The guarantor must, before paying a claim, ascertain whether the underlying obligation was breached in order to establish whether the claim is justified, and the guarantor is normally entitled to invoke all the defences that the principal could invoke against the beneficiary.

5. The discussion in the legal guide is limited to independent guarantees, without thereby implying a preference for this type of guarantee. Generally, independent guarantees are used to support obligations set out in the countertrade agreement. While principals tend to prefer accessory guarantees, beneficiaries are normally reluctant to accept such guarantees

because of the possible delays involved in obtaining payment. Moreover, guarantors, in particular banks, tend to prefer independent guarantees because they do not wish to investigate the performance of the underlying obligation. While the various legal regimes governing accessory guarantees are well established, independent guarantees, essentially a creation of banking and commercial practice, are not yet firmly established in all legal systems and there is no uniformity as regards the extent to which independent guarantees are recognized.

6. In some countries banks issue "stand-by letters of credit", which are the functional equivalent of independent guarantees. Accordingly, the discussion in the legal guide on guarantees for security for performance by the principal applies to stand-by letters of credit.

B. Guarantee provisions in countertrade agreement

7. When the parties decide to use a guarantee to support the countertrade commitment, they should include in the countertrade agreement certain basic provisions concerning the issuance and terms of the guarantee. The parties may also wish to consider appending to the countertrade agreement a form of a guarantee to be followed by the issuer in establishing the guarantee. In formulating the terms of the future guarantee in the countertrade agreement, the parties should be sure that the agreed formulation would be accepted by the guarantor.

8. Typically it is the party committed to purchase whose commitment is supported by a guarantee. In many cases this is because the primary objective of that party in agreeing to a countertrade commitment is to secure a sale, rather than to obtain goods from the other party. When the party committed to purchase goods has a particular interest in obtaining the goods, the supplier's commitment to conclude a contract for the supply of the agreed goods may be supported by a guarantee. In some cases, the countertrade agreement may require both the purchaser and the supplier to obtain guarantees to support their commitments. When the parties to the countertrade agreement foresee that a third person may assume the countertrade commitment, the parties may wish to consider whether the guarantee should be procured by the party originally committed to purchase or supply the goods or by the third person (see chapter VIII, "Participation of third persons").

9. When the guarantee supports the principal's obligation under a liquidated damages or penalty clause, the question whether a payment under the guarantee would free the principal from liability for fulfilment of the countertrade commitment would be settled by the terms of the liquidated damages or penalty clause and the rules applicable to the clause (see chapter XI, "Liquidated damages and penalties", paragraphs ____ to ____). When the guarantee does not support a liquidated damages or penalty clause and the parties intend, as is sometimes the case, that payment under the guarantee would have the effect of freeing the principal from the countertrade commitment or from liability for any damages exceeding the amount paid under the guarantee, they should state their intention in the countertrade agreement. Without a provision to this effect, it cannot be assumed that payment under the guarantee would free the principal from the countertrade commitment or from liability for damages.

1. Choice of guarantor

10. The parties may wish to specify in the countertrade agreement a guarantor who would be acceptable to both parties. That would enable the beneficiary to be satisfied that the guarantee would be issued by a guarantor that had the necessary financial reserves and that was otherwise acceptable. The identification of the guarantor could be useful to both parties in that it would limit subsequent disagreements and enable the parties to know the cost of the guarantee at the outset.

11. If the guarantor is not identified at the time of the conclusion of the countertrade agreement, the parties may provide, for example, that the guarantor be a first class bank, be agreeable to the beneficiary or be an institution from the home country of one of the parties.

12. A beneficiary may wish to have the guarantee issued by an institution in its home country because enforcement of a claim for payment against such an institution could be easier than against a foreign institution. However, requiring the use of a local guarantor may be disadvantageous to the extent that the principal is prevented from using a guarantor with whom it has an established relationship and who may provide the same guarantee at a lower cost.

13. In some legal systems, mandatory rules applicable to the beneficiary provide that a guarantee may be accepted only if it is issued by a financial institution in the country or a financial institution authorized to issue guarantees involving payment in a foreign currency or if the selection of the guarantor is approved by the competent authority.

14. There have been instances where an undertaking to pay a sum of money, termed a "guarantee", supporting the countertrade commitment or the payment of related liquidated damages or penalties has been made by the party whose countertrade commitment is to be guaranteed. The effect of such a "guarantee" is that the party-guarantor promises to pay the other party under the terms of the guarantee without raising any defence that could not have been raised by a third-party guarantor, and that it is up to the party-guarantor to sue for reimbursement of the funds paid if it is claimed that the underlying obligation had not been breached. Such a guarantee might be acceptable to the beneficiary if the guarantee is independent from the underlying transaction and is issued by a trading party whose commercial integrity and financial adequacy are regarded by the beneficiary as being beyond doubt. However, it is not clear that such a guarantee gives the beneficiary legal rights in addition to those arising from the obligation being guaranteed.

2. Conditions for obtaining payment under the guarantee

15. The countertrade agreement should clearly set forth the conditions that have to be fulfilled in order for the guarantor to be obligated to pay, in particular, as to any documents that have to be submitted in support of a claim for payment. Disputes may arise from uncertainty as to whether the documents presented by the beneficiary conform to the terms of the guarantee.

16. The terms of an independent guarantee may provide that a demand for payment alone would suffice or that the demand would have to be accompanied by the beneficiary's statement concerning the breach. A general declaration to

that effect may be sufficient. Alternatively, the beneficiary may be required to state more details, such as the nature of the principal's breach, that the beneficiary is entitled to payment of the claimed amount and that the amount has not yet been paid. In addition to the demand for payment, the beneficiary may be required to present documents issued by a third person relating to the default by the principal, such as an arbitral award or court decision stating that the default has occurred. The guarantee may provide that the requirement of a third-person statement would be obviated if the principal makes an admission of default in writing. In all these cases, the guarantor merely ascertains whether the documents conform on their face to the requirements of the guarantee and is not to inquire into the underlying transaction. In particular, the guarantor is not to investigate whether the statements contained in a document are founded.

17. Sometimes the parties agree that the beneficiary must notify the principal of the intention to call the guarantee and that the claim cannot be made before the expiry of a specified period of time following the notice. The purpose of such a notice requirement is to provide an opportunity to the principal to cure a breach or to settle a disagreement. A corollary guarantee term would require the beneficiary to submit with the demand for payment documentary evidence that notice had been given to the principal.

18. Where the guarantee supports the payment obligation under a liquidated damages or penalty clause, the parties may wish to stipulate that among the payment conditions would be a requirement that the beneficiary provide a statement that payment under the liquidated damages or penalty clause is due.

19. In addition to documentary conditions, a guarantee will usually specify requirements that do not pertain to the performance of the underlying obligation. Such requirements, which do not involve the presentation of a document, most frequently concern the time period within which a claim can be made, the amount of the guarantee, and the office of the guarantor where the claim is to be submitted.

20. It is advisable that the countertrade agreement, in addition to setting out the agreement of the parties as to the guarantee, provide that the beneficiary is entitled to claim under the guarantee only if there is in fact a failure to fulfil the commitment. Such a provision might facilitate recovery by the principal of losses suffered in the event a claim has been paid without there having been a breach of the underlying obligation.

3. Amount of guarantee and reduction of amount

21. The parties should agree on the amount of the guarantee, as well as the currency in which it is to be denominated and payable. The amount of the guarantee is expressed as a specified amount or as a percentage of the value of the outstanding commitment. If the guarantee is supporting payment under a liquidated damages or penalty clause, the guarantee clause in the countertrade agreement may call for payment of the entire amount of the liquidated damages or penalty or a portion thereof. The liquidated damages or penalty may itself be a certain percentage of the unfulfilled countertrade commitment.

22. In determining the amount of the guarantee, or of the liquidated damages or penalty covered by the guarantee, the parties would take into account factors such as the extent of the losses expected to be suffered in

the event of non-fulfilment and the risk of failure to fulfil, as well as the limits which guarantors would usually observe in respect of similar contracts. Another factor may be the ease with which payment of a claim under the guarantee can be obtained. In this respect, the beneficiary generally has a trade-off to make. The closer the terms of the guarantee approach that of a simple demand guarantee and the easier it will be to obtain payment, the less willing the principal will be for the guarantee to cover a high percentage of the countertrade commitment. On the other hand, if the documentary conditions are more difficult to meet when the principal has not breached the commitment (e.g., when an arbitral or court decision must be presented), the principal may be willing to agree on a higher amount for the guarantee.

23. The parties may wish to include in the terms of the guarantee a mechanism to reduce the amount of the guarantee as fulfilment of the countertrade commitment progresses. Reduction of the guarantee amount would have the advantage of reducing the exposure under the guarantee and possibly the cost of the guarantee. If the guarantee secures payment of liquidated damages or a penalty, the provisions on the reduction of the guarantee should be consistent with any reduction mechanism for the sum of the liquidated damages or penalty.

24. It is advisable that the reduction mechanism operate on the basis of the presentation to the guarantor of specified documents evidencing fulfilment of the countertrade commitment, without the guarantor being obligated to verify the degree to which the countertrade commitment has been fulfilled. These documents may include shipping documents, copies of supply contracts, purchase orders, letters of release or other documents recording fulfilment. The parties may also find it useful to stipulate the issuer of the documents and the party responsible for forwarding them to the guarantor. Where the fulfilment period is divided into subperiods, the parties may wish to provide that the guarantee will be reduced by the amount allocated for each subperiod and not claimed within the agreed period of time.

4. Time of providing guarantee

(a) At entry into force of countertrade agreement or shortly thereafter

25. The parties are advised to agree on the point of time when the guarantee is to be issued. It may be agreed, for example, that the guarantee should be issued to the beneficiary when the countertrade agreement enters into force or shortly thereafter (e.g., thirty days after entry into force of the countertrade agreement). The parties may obtain assurance that the guarantee would be procured at the agreed time by providing that the countertrade agreement would not enter into force without procurement of the guarantee or that the principal would be deemed to have breached the countertrade commitment if the guarantee was not procured within the agreed period of time.

26. When a contract in one direction (export contract) is concluded together with the countertrade agreement, the parties could agree that the issuance of a guarantee supporting fulfilment of the countertrade commitment is a condition for the entry into force of the export contract. Such a provision would assure the importer of not being bound under the export contract before issuance of a guarantee to support the countertrade commitment.

(b) Later in fulfilment period

27. The parties may agree that the guarantee does not have to be procured until a certain date later in the fulfilment period provided that at that time fulfilment of the commitment has not been completed. The agreed date may be, for example, three months before the end of the fulfilment period or three months before the end of each yearly segment of a multi-year fulfilment schedule. This approach has the advantage that the amount of the guarantee could be calculated as a percentage of the then outstanding countertrade commitment. By making the amount of the guarantee dependent on the outstanding balance rather than on the entire countertrade commitment and by limiting the length of time during which a guarantee is in effect, the extent of exposure under the guarantee as well as the cost of the guarantee are likely to be reduced.

28. Since such an approach exposes the beneficiary to the risk that the guarantee will not be procured, the parties may wish to agree on the beneficiary's rights in the event the guarantee is not procured as agreed. It may be agreed that the beneficiary would be permitted to regard the countertrade commitment as breached and to claim payment under a liquidated damages or penalty clause. Furthermore, it might be agreed that the beneficiary would be entitled to deduct the amount of the liquidated damages or penalty from any amounts becoming due under the export contract after the failure to procure the guarantee.

5. Duration of guarantee

(a) Expiry date

29. It is advisable for the parties to agree in the countertrade agreement on the length of time the guarantee is to remain in force. One possible approach would be to provide for an open-ended guarantee that would terminate only when fulfilment of the commitment is deemed to be achieved or the committed party is otherwise released from the commitment (see chapter VII, "Fulfilment of countertrade commitment", paragraphs ____ to ____). Another approach would be to provide a fixed expiry date. It should be noted that most guarantors may be willing to issue guarantees only if the expiry date is fixed. Furthermore, the Uniform Customs and Practice for Documentary Credits (1983 Revision, Publication No. 400 of the International Chamber of Commerce), under which stand-by letters of credit may be issued, calls, in its article 46, for the stipulation of an expiry date for presentation of documents.

30. It is advisable that the expiry date of the guarantee fall after the end of the period for the fulfilment of the countertrade commitment. A period of time between expiry of the fulfilment period and expiry of the guarantee (e.g., thirty days) would allow the beneficiary to await the conclusion of supply contracts until the close of the fulfilment period without foregoing the possibility of claiming payment under the guarantee. Furthermore, the beneficiary, at its discretion, would be able to allow minor delays attributable to the principal in the fulfilment of the countertrade commitment without foregoing the possibility of claiming payment under the guarantee. At the same time, a relatively short interval would allow the liability of the guarantor to be resolved relatively soon after the alleged non-fulfilment of the countertrade commitment has taken place. The parties may also wish to apply such an approach in relation to guarantees covering subperiods of a fulfilment period.

31. If the security takes the form of a stand-by letter of credit, it should state expressly that it is irrevocable. The need for such a statement arises because article 7(c) of the Uniform Customs and Practice for Documentary Credits (1983 Revision, Publication No. 400 of the International Chamber of Commerce), which will often be applicable, provides that a credit is deemed to be revocable in the absence of an express indication that it is irrevocable.

(b) Return of guarantee instrument

32. In some legal systems a guarantee may remain in force even after the expiry date if the guarantee instrument is not returned by the beneficiary. The countertrade agreement should therefore obligate the beneficiary to return the guarantee promptly upon fulfilment of the guaranteed obligation. However, the obligation to return the guarantee should be drafted so as not to imply that if the guarantee is not returned it remains in force even after the expiry date.

(c) Extension

33. For various reasons, the time period for fulfilment of the countertrade commitment may be extended and as a result continue beyond the expiry date of the guarantee (see chapter VII, "Fulfilment of countertrade commitment", paragraphs ____ to ____, concerning extension of the fulfilment period). The countertrade agreement might provide that, if the fulfilment period is extended, the principal would be obligated to arrange within a reasonable period of time a corresponding extension of the guarantee. Alternatively, the guarantee might provide for an automatic extension to cover any extension of the underlying fulfilment period agreed to by the parties. However, such a provision might not be acceptable to a guarantor who does not wish to be bound by a guarantee whose duration depends on an agreement to which the guarantor is not a party.

34. With respect to the cost of extending the period of validity of the guarantee, the parties may wish to agree that the party responsible for the extension of the fulfilment period will be obligated to bear the costs of the extension of the guarantee period.

6. Modification or termination of countertrade agreement

35. In legal systems that recognize the agreement of the parties to establish an independent guarantee, an independent guarantee would remain in effect as stipulated regardless of changes in the underlying commitment. If the change in the underlying contract affects the possibility to obtain the documents in support of the payment claim under the independent guarantee, it should be ensured that the change in the underlying contract be reflected by a corresponding modification of the guarantee terms.

36. Under some legal systems that do not fully recognize an independent guarantee, an alteration of the underlying commitment may result in the release of the guarantor; under other such systems, the guarantee may be deemed to cover only the commitment of the principal existing at the date of issuance of the guarantee. With a view to avoiding undesired consequences, the parties may provide that the guarantee would remain in force despite modifications of the countertrade agreement.

37. The modification of the countertrade agreement may extend the liability of the principal beyond the amount of the guarantee. The parties may wish to provide in the countertrade agreement that in those cases the principal would be obligated to ensure that the amount of the guarantee would be modified accordingly.

C. Guarantee for imbalance in trade

38. The parties may agree that goods will be shipped in exchange for goods and that the shipments in each direction will not be paid for in money. This type of transaction may be based on a barter contract (see chapter III, "Contracting approach", paragraphs ___ to ___) or on the setoff of countervailing claims for payment (see chapter IX, "Payment", paragraphs ____ to ____). In such cases a supplier runs the risk that the value of its shipments may exceed the value of goods received from the other party and that this surplus is not liquidated, either by supplies of goods or through payment in money. In order to address this risk, the parties may use guarantees to secure liquidation of an imbalance that may develop in the flow of trade.

39. The amount of the guarantee should be linked to the amount of the imbalance in the flow of trade, with an upper limit. This upper limit for the guarantee could be set at the level of imbalance permitted under the countertrade transaction. It may be agreed that the amount that could be claimed under the guarantee would cover less than the full extent of the imbalance (e.g., 80 percent). The purpose of such an approach would be to discourage the calling of the guarantee except as a last resort. A beneficiary who cannot recover the full amount of the imbalance by calling the guarantee would have a greater incentive to achieve the agreed balance in the flow of trade through ordering goods from the other party.

1. Guarantee for shipment in one direction

40. Where a particular sequence of shipments in the two directions is stipulated, the countertrade agreement may provide that the party scheduled to receive goods first must provide a guarantee supporting the obligation to ship goods in return. This guarantee would cover the risk taken by the party that ships first that the return shipment fails to take place by the agreed date or is not of the agreed value or quantity. When the first shipment is to take place in stages, it may be agreed that with each partial shipment a separate guarantee is to be provided corresponding to the value of that shipment; alternatively, the guarantor may agree to increase the amount of the guarantee upon the presentation of documents evidencing additional shipments.

41. With respect to the timing of the issuance of the guarantee, the countertrade agreement may provide that the guarantee is to be handed over to the beneficiary in exchange for the shipping documents relating to the first delivery. Such a procedure would safeguard against the possibility that the party scheduled to ship first obtains the guarantee but fails to ship. In order to ensure that the beneficiary of the guarantee (the party that has shipped first) would not be in a position to claim payment under the guarantee once the principal (the party shipping second) has fulfilled its obligation to ship goods, the countertrade parties may agree that the beneficiary of the guarantee would obtain documents of title to the second shipment only upon surrender of the guarantee instrument.

42. Guarantees may be used in a similar fashion in multi-party countertrade transactions. When the parties link deliveries in such a fashion that the importer, in exchange for goods received from the exporter, ships goods to a third-party counter-importer, the third-party counter-importer pays the exporter (see chapter IX, "Payment", paragraphs ____ to ____). The guarantee, provided by the importer, would support the obligation to counter-export after receiving the export goods. When the exporter is to be paid by the counter-importer upon shipment of the export goods, the counter-importer would be the beneficiary of the guarantee. Such a guarantee would cover the risk taken by the counter-importer in paying the exporter prior to receiving goods from the counter-exporter. When, however, the counter-importer is to pay the exporter only upon receipt of the counter-export goods, the exporter would be the beneficiary of the guarantee. Such a guarantee would cover the risk that the exporter, having shipped goods, failed to be paid by the counter-importer because the counter-export did not take place.

43. A similar guarantee may be used when the exporter, instead of being paid by the importer, receives goods from a third-party counter-exporter, who in turn is paid by the importer (see chapter IX, "Payment", paragraphs ____ to ____). In this case, it may be agreed that the exporter would be given a guarantee covering the risk that, having shipped first, the exporter failed to be compensated by a shipment of goods from the counter-exporter.

44. A guarantee may be employed in a similar fashion when both the counter-importer and the counter-exporter are separate parties from the exporter and the importer (see chapter IX, "Payment", paragraphs ____ to ____). It may be agreed that the importer must provide a guarantee to the exporter to support the importer's obligation to pay the price of the export goods. When the exporter is to receive payment from the counter-importer upon shipment of the export goods, the beneficiary would be the counter-importer. This would protect the counter-importer against the risk of paying the exporter without receiving goods from the counter-exporter. When, however, the counter-importer is to pay the exporter only upon shipment of the counter-export goods, the beneficiary of the guarantee would be the exporter. This would protect the exporter against the risk of shipping goods without being paid.

2. Mutual guarantees

45. When the parties agree to exchange goods for goods, they may do so without stipulating a particular sequence in which the shipments in the two directions should take place. This is particularly likely when multiple shipments in each direction are envisaged. In such situations, both parties encounter the risk of an imbalance in the flow of trade which needs to be redressed either through the shipment of goods or through the payment of a sum of money. To address this risk, it may be agreed that each party is to provide a guarantee to secure liquidation of an imbalance in favour of the other party.

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INTERNATIONAL COUNTERTRADE

Draft legal guide on drawing up contracts in international countertrade transactions: sample chapters*

Report of the Secretary-General

Addendum

VII. FULFILMENT OF COUNTERTRADE COMMITMENT

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* The text contained herein is a first draft prepared by the Secretariat for consideration by the Commission as part of the preparatory work on the draft legal guide on drawing up contracts in international countertrade transactions and should not be regarded as stating the views of the Commission.

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A. General remarks

1. The countertrade agreement should address several questions related to the fulfilment of the countertrade commitment. One question concerns the types of supply contracts that are eligible to be counted towards fulfilment (paragraphs 2 to 9 below). Another question is whether the countertrade commitment is fulfilled at the moment when the parties enter into a supply contract or at some subsequent point during the performance of the supply contract (paragraphs 10 to 12 below). A further question is whether an amount equivalent to the price payable under a supply contract, or a greater or lesser amount, is to be subtracted from the outstanding countertrade commitment (paragraphs 13 to 16 below). Yet another question concerns the period of time during which the countertrade commitment is to be fulfilled (paragraphs 17 to 30 below). The parties may also wish to establish procedures for monitoring and recording fulfilment (paragraphs 31 to 44 below).

B. Defining eligible supply contracts

2. The parties normally define the supply contracts that will be counted towards fulfilment of the countertrade commitment ("eligible supply contracts") by indicating in the countertrade agreement the type of goods to be purchased under those future supply contracts. In some cases, the parties include in the countertrade agreement additional criteria relating to the geographical origin of the goods, the identity of the supplier, or the identity of the purchaser. When the parties are not in a position to indicate the type of goods in the countertrade agreement, some of these criteria may be included for the purpose of defining eligible supply contracts.

1. By type of goods

3. When the parties define the contracts eligible to be counted towards fulfilment by indicating the type of goods to be purchased, it is advisable that they do so with as much precision as possible. Precision is particularly advisable when the goods to be purchased exist in different varieties. (For a discussion of clauses in the countertrade agreement concerning the type of goods, see chapter V, "Type, quality and quantity of goods", paragraphs 2 to 11.)

4. Sometimes the parties provide in the countertrade agreement that, in addition to the purchase of the countertrade goods, other related items are to be counted towards fulfilment of the countertrade commitment. Such ancillary items may be, for example, purchase of samples and prototypes in the course of selecting the countertrade goods, local contracting of labor, local purchase of goods and services essential for carrying out a supply contract, unbilled activities by the purchaser in the supplier's country (e.g., recruitment of personnel, training programs, secondment of staff and other forms of technical assistance), purchase from the supplier of transportation services, or performance by the purchaser of after-sales service on the countertrade goods. The countertrade agreement may provide that only a limited portion of the countertrade commitment may be fulfilled through such items.

5. When the purchaser has made prior purchases from the supplier, the countertrade agreement may provide that supply contracts must meet an "additionality" requirement in order to be counted toward fulfilment (see chapter V, paragraphs 26 and 27).

2. By geographical origin

6. Eligibility of supply contracts may be defined by a stipulation that countertrade goods must be produced in a particular geographical area. Stipulations of this type are sometimes found in indirect offset transactions where the importer wishes to channel the counter-purchases to a particular region. Furthermore, the countertrade agreement may stipulate a required minimum level of local content. Such stipulations may provide that particular components of the goods must be locally produced or that the value of local components must constitute a certain percentage of the total value. Local content requirements are sometimes found in governmental regulations.

3. By identity of supplier

7. The parties may agree that the exporter is to fulfil the countertrade commitment by purchasing goods from persons other than the importer. This is typically the case in indirect offset (see chapter II, paragraph 13). In such cases, it is advisable that eligible supply contracts be defined by identifying the suppliers from whom the goods are to be purchased. The countertrade agreement may list eligible suppliers or may stipulate criteria to be observed by the purchaser in selecting a supplier. It may be provided, for example, that a selected supplier must be from a particular economic sector, be of a certain size, have a particular production programme, be located in a particular region, or be locally owned. Where several eligible suppliers are identified, the purchaser may be left free to distribute purchases among various suppliers or a particular structure of purchases from the identified suppliers may be stipulated. The identification of eligible suppliers does not necessarily mean that those suppliers have made a commitment to make countertrade goods available. In some cases the importer may provide an assurance that the eligible suppliers are prepared to negotiate the conclusion of a supply contract or promise to assist the purchaser in identifying a supplier who is willing to conclude a supply contract. (For a discussion of the participation of third persons as suppliers, see chapter VIII, paragraph .) The countertrade agreement may indicate the effect on the countertrade commitment if none of the eligible suppliers are prepared to conclude a supply contract.

4. By identity of purchaser

8. A restrictive element sometimes found in the definition of eligible supply contracts concerns the identity of the purchaser. For example, the countertrade agreement may provide that only purchases made by the party committed to purchase goods or by specified third persons (e.g., third persons from a particular country or geographical region) are to be counted toward fulfilment. For a discussion of restrictions on the participation of third persons as purchasers, see chapter VIII, paragraph .

5. Non-conforming purchases

9. The parties may agree that under certain circumstances purchases that do not conform to the eligibility requirements in the countertrade agreement

would be counted toward fulfilment of the countertrade commitment. For example, non-conforming purchases could be counted if the good faith efforts of the purchaser to locate suitable goods from the eligible suppliers or in the geographical regions or economic sectors identified in the countertrade agreement were unsuccessful. A provision of that type could call upon the purchaser to provide evidence of efforts to make purchases of the type required by the countertrade agreement (for a discussion of the analogous case of a party requesting an extension of the fulfilment period, see paragraphs 23 to 26 below). It could be agreed that the specific prior consent of the party to whom the commitment is owed would be necessary for the purchases not meeting the eligibility requirements to be counted toward fulfilment. In order to foster efforts to comply with origin requirements, the countertrade agreement could limit the availability of an exception to the later stages of the fulfilment period. Furthermore, the parties may agree that purchases counted toward fulfilment that fall outside the eligibility provisions are to be counted at less than the full value of the purchases (see paragraphs 14 and 15 below).

C. Stage when commitment fulfilled

10. It is advisable that the countertrade agreement indicate the specific events that must occur in order for the countertrade commitment to be fulfilled. The parties may chose between two basic approaches. Under one approach, the countertrade commitment is deemed to be fulfilled once a supply contract is concluded. In such cases, a breach of an obligation under the supply contract would be subject to remedies available under the supply contract. The parties may agree that, if the supply contract is not performed due to a reason imputable to one party, the amount of the unperformed contract could, at the option of the other party, be reinstated in the countertrade commitment.

11. Under the other approach, the commitment is deemed to be fulfilled at an agreed stage in the performance of the supply contract. For example, it may be agreed that the commitment of the purchaser is fulfilled when the letter of credit is opened or when the funds have been transferred to the supplier and the corresponding commitment of the supplier is fulfilled when the goods are delivered or placed at the disposal of the purchaser in the agreed manner. In such cases, in the event of a breach of the supply contract, the non-breaching party might be able to invoke remedies not only for breach of the supply contract, but also for breach of the countertrade agreement if the countertrade commitment remained unfulfilled.

12. The parties may wish to address the effect on the countertrade commitment of a failure to conclude or perform a supply contract. It may be agreed, for example, that when the reason for such a failure is imputable to one of the parties, the outstanding countertrade commitment of the other party may, at the option of that other party, be deemed fulfilled in the amount of the unaccepted contract offer or unperformed contract (see chapter XIII, "Interdependence of obligations", paragraph).

D. Amount of fulfilment credit

13. In many countertrade transactions, the full purchase price of a supply contract is deducted from the outstanding countertrade commitment (the

amount deducted from the outstanding countertrade commitment is hereinafter referred to as "fulfilment credit"). Sometimes the parties agree that the fulfilment credit granted for a supply contract is to be an amount different than the purchase price. One reason for such an approach may be that the parties wish to give fulfilment credit for certain costs (e.g., transportation and insurance) not included in the purchase price or to exclude from the fulfilment credit certain costs included in the purchase price. The supplier may agree to the crediting of such cost elements if, for example, they involve the purchase in the supplier's country of services related to the performance of the supply contract.

14. The countertrade agreement may provide that purchases are to be credited toward fulfilment of the countertrade commitment at different rates depending upon the type of goods purchased. For example, fulfilment credit could be granted at the rate of 50 per cent of the purchase value for one type of goods and 150 per cent for another. Such a variable rate of fulfilment credit could be desirable for a supplier who wishes to promote the purchase of certain types of goods. In an offset transaction, the countertrade agreement may provide that investments or technology transfer will be credited at more than the capital contribution of the investment or the monetary value of the technology transfer (e.g., 150 percent). In direct offset, as well as in buy-back, the countertrade agreement may provide that a certain amount of fulfilment credit will be granted for export sales, other than those to the counter-importer, generated by the production facility supplied by the exporter. Credit may also be granted for a percentage of the value of sales to buyers in the counter-exporter's country.

15. The countertrade agreement may also provide for different rates of fulfilment credit depending upon the identity of the supplier, the geographical origin of the goods or the identity of the purchaser. The rationale behind such a provision is to steer the activities of the purchaser towards particular suppliers or regions, or to introduce the goods in certain markets.

16. The rate of fulfilment credit may also be made to vary according to the point of time when a purchase is made. Under a scheme of this type, the purchaser could fulfil the countertrade commitment by the purchase of a smaller quantity of goods if a supply contract was concluded at an early stage of the period for the fulfilment of the countertrade commitment. This approach is designed to give the purchaser an incentive for fulfilling the commitment earlier rather than later in the fulfilment period. In such a case it is particularly important that the countertrade agreement specify the point when fulfilment credit is to be given (e.g., when an order is placed or when payment is made).

E. Time period for fulfilment of countertrade commitment

1. Length of fulfilment period

17. The parties should specify in the countertrade agreement the length of time to be allowed for fulfilment of the countertrade commitment (hereinafter referred to as the "fulfilment period"). The countertrade agreement may determine the length of the fulfilment period by stipulating that the fulfilment period is to commence upon a fixed date and to expire on a fixed date.

18. Another method is to make the commencement of the fulfilment period contingent upon an event specified in the countertrade agreement and to set the length of the fulfilment period. Such an approach may be desirable in a variety of circumstances. For example, when the conclusion of the countertrade agreement precedes the entry into force of the export contract, the parties may agree that the fulfilment period will not begin until the export contract has entered into force. When there is uncertainty at the time of the conclusion of the countertrade agreement about the availability of countertrade goods or about the ability of the purchaser to utilize or market them, the parties may agree that the fulfilment period will commence upon the completion of certain preparatory activities (e.g., identification of goods, inspection by purchaser, certification of the technical capability of the factory producing the goods, agreement with a third-party purchaser or completion of joint marketing research). Where the exporter wishes to ensure that performance of the export contract is at an advanced stage or completed before performance of the countertrade commitment commences, the parties may stipulate in the countertrade agreement that commencement of the fulfilment period is to be triggered by an event in the performance of the export contract such as the opening of the letter of credit, delivery of a specified portion of the goods or payment. In a buy-back transaction, an appropriate moment might be the beginning of production of buy-back products by the facility supplied under the export contract. In order to avoid uncertainty as to whether the conditions for commencement of the fulfilment period have been met, it is advisable that the countertrade agreement state those conditions and the related obligations of the parties as precisely as possible.

19. In determining the length of the fulfilment period the parties should consider a number of factors. One factor is the size and type of the transaction being contemplated. For example, where the countertrade commitment is large and involves a series of shipments, more time would normally be needed for fulfilment of the countertrade commitment than if the transaction were relatively small. Where the countertrade agreement defines the countertrade goods in broad terms, it may be that a longer fulfilment period would be needed in order to allow time for identifying suitable countertrade goods. The quality of the countertrade goods may affect the length of the fulfilment period. The better the quality, the more likely it will be that the purchaser will either be able to market or use them in-house, thus allowing a shorter fulfilment period.

20. In some cases, the length of the fulfilment period is set so that it extends beyond the date when payment is due under the export contract. Such an approach would allow the exporter time to fulfil the countertrade commitment after payment under the export contract is due. In such a case it is in the interest of the importer to include in the countertrade agreement effective sanctions for breach of the countertrade commitment.

21. The parties may agree that the fulfilment period for the shipment in one direction is to be of the same length as the fulfilment period for the shipment in the other direction. Such an approach may be appropriate when no particular importance is attached to the order of the shipments in the two directions (e.g., countertrade carried out within the framework of a setoff account (chapter IX, "Payment", paragraphs 35 to 52) or an evidence account (paragraphs 38 to 44 below)). Such an approach may also be appropriate in a

counter-purchase transaction in which the counter-importer is prepared to begin fulfilling the countertrade commitment without waiting to be paid under the export contract.

22. The fulfilment period should be of a sufficient length to take into account difficulties the supplier may encounter in making the countertrade goods available. If the goods are not made available in time, the purchaser could object to the exercise by the supplier of remedies for non-fulfilment of the countertrade commitment by claiming that non-fulfilment was due to unavailability of the goods. If the purchaser is entitled to select the goods from a list of eligible countertrade goods, the length of time needed to make available each of the different goods listed should be taken into account calculating the length of the fulfilment period.

2. Extension of fulfilment period

23. The parties may require more time to fulfil the countertrade commitment than provided by the countertrade agreement. For example, a purchaser may encounter unanticipated difficulties in utilizing or reselling the goods to be purchased. A supplier may have difficulties in making agreed upon goods available on schedule.

24. The law applicable to the countertrade agreement may provide for an extension of the time allowed for the performance of a party's contractual obligations in the event that the possibility of performance is affected by circumstances beyond the control of that party. The parties may wish to include in the countertrade agreement clauses addressing such situations (see chapter XIII, paragraphs to , for a discussion of exemption and hardship clauses).

25. The countertrade agreement may provide that an extension would be granted if the party seeking an extension has made good faith efforts to fulfil the commitment. It is advisable that such a provision indicate how the purchaser could demonstrate good faith efforts. For example, in an indirect offset, it may be provided that the purchaser would have to show a certain number of contacts with potential suppliers in search of suitable countertrade goods. The countertrade agreement may also provide that a supplier who was unable to make goods available due to circumstances specified in the countertrade agreement would be entitled to an extension. Such circumstances may include, for example, lateness of the purchaser's order or changes in the purchaser's specifications. The parties may agree that a party could request an extension of the fulfilment period only if that party had fulfilled a portion of the countertrade commitment.

26. If the fulfilment of the countertrade commitment is supported by a guarantee, it is advisable that the parties provide that the period of the guarantee should be extended to cover an extension of the fulfilment period (see chapter XII, "Security for performance", paragraphs 33 and 34).

3. Subperiods within fulfilment period

27. Where fulfilment of the countertrade commitment involves many shipments over a long period of time, the parties may wish to divide the fulfilment period into subperiods. For example, a five year fulfilment period could be divided into five annual subperiods, with a specified portion

of the total commitment to be fulfilled during each subperiod. Such an approach assists the parties in planning delivery and marketing of the countertrade goods, and helps to ensure that fulfilment does not fall so far behind that the parties would be unable at the latter stages of the fulfilment period to fulfil the outstanding countertrade commitment.

28. The countertrade agreement may allow flexibility in dealing with shortfalls in the fulfilment of the commitment assigned to individual subperiods by permitting the carry-over of all or a portion of a shortfall to the next subperiod. In such a case, the purchaser would have, in the following subperiod, to fulfil the portion of the commitment allocated to that subperiod, as well as to fulfil the portion of the commitment carried over from the the preceding period. The portion not carried over would be subject to sanctions for failure to fulfil the countertrade commitment (see chapters XI, "Liquidated damages and penalties", and XII, "Security for performance"). Such flexibility would allow the purchaser to adjust the quantity to be purchased in a given subperiod in response to circumstances such as short term market fluctuations. However, a high degree of flexibility might adversely affect the interests of the supplier if the proceeds of sales in each subperiod are to be used for payments under the supply contract in the other direction.

29. To address the possibility that the fulfilment achieved in a given subperiod exceeds the required level, the parties may agree that some or all of the extra purchases would be credited to the commitment due in the following subperiod. Alternatively, the parties may agree that the excess fulfilment in one subperiod would not affect the level of the commitment due in the following subperiod.

30. The parties may wish to set deadlines within the fulfilment period for completion of different actions related to fulfilment of the countertrade commitment. For example, the parties could stipulate deadlines for providing samples of countertrade goods, placing orders, shipping goods or opening letters of credit.

F. Monitoring and recording fulfilment of countertrade commitment

31. The parties may wish to consider establishing procedures for monitoring and recording the progress made in fulfilment of the countertrade commitment. Such arrangements may be particularly useful in long term countertrade transactions with multiple shipments in one or both directions.

1. Exchange of information

32. The parties may wish to establish procedures for exchange of information on progress in the fulfilment of the countertrade commitment. Such procedures may be useful, in particular, in "indirect offset" transactions (chapter II, "Introduction", paragraph 13), since the countertrade commitment is owed to a person who does not act as the supplier of the countertrade goods and the potential suppliers are, therefore, not parties to the countertrade agreement. A system of exchange of information may also be useful when the parties are engaged in a large volume of mutual trade, especially when only a part of that trade stems from the countertrade agreement.

33. The parties may include in the countertrade agreement guidelines concerning the contents, frequency and timing of the information to be exchanged. The required information could cover, for example, contracts that have been concluded that are eligible to be counted towards fulfilment (especially when concluded with a third person), shipments that have been made, payments effected in accordance with agreed upon procedures and purchases planned for an upcoming subperiod of the fulfilment period. Furthermore, the parties to the countertrade agreement sometimes find it useful to meet periodically to assess the progress that is being made towards fulfilment. Such meetings could be used to review the status of concluded contracts and those under negotiation and to consider possible modifications of the countertrade agreement. The countertrade agreement could address questions such as the frequency and location of meetings and the representation of the two sides.

34. In particularly complex transactions that require ongoing monitoring and coordination, the parties may wish to establish in the countertrade agreement a joint coordination committee. It is advisable that the parties address issues such as the frequency and location of meetings, representation of the two sides, the manner in which the results of the meetings will be reported and the mandate of the committee. The mandate of such a committee would typically be to assess progress in the implementation of the transaction, analyse difficulties and consider possible solutions, establish working groups for specific problems, and consider proposals to amend the countertrade agreement.

2. Confirmation of fulfilment of countertrade commitment

35. The parties may agree that the purchaser has a right to obtain from the party to whom the countertrade commitment is owed a written confirmation of the fulfilment of the countertrade commitment. Such a confirmation may take the form of a statement from the supplier (sometimes referred to as a "letter of release"). The parties may agree that the letter of release is a condition for payment under the supply contract concluded in fulfilment of the countertrade commitment (e.g., the letter of credit terms may specify that the letter of release is to be among the documents presented to the bank in order to obtain payment). Fulfilment of the countertrade commitment may also be confirmed by a clause in the supply contract stating that the contract is concluded in fulfilment of the countertrade commitment.

36. Written confirmation of fulfilment is intended to avoid disagreements, which may occur after a particular supply contract has been performed, as to whether the contract counts towards fulfilment of the countertrade commitment. Written confirmation may also be helpful to a party who wishes to demonstrate (e.g., in negotiating other countertrade agreements) a record of fulfilling countertrade commitments.

37. Where written confirmations are envisaged in a multiparty transaction (see chapter VIII, "Participation of third persons", paragraphs to), it is advisable that the countertrade agreement indicate whether the fulfilment of the commitment is to be confirmed by the supplier of the goods or by the party to whom the commitment is owed. Absent such an indication, a disagreement may arise between the purchaser and the party to whom the commitment is owed as to the significance of a statement by a third-party

supplier that a supply contract fulfils the countertrade commitment, or of a clause in a supply contract with a third-party supplier to that effect.

3. Evidence accounts

38. The parties may agree that their mutual shipments of goods are to be recorded in a ledger kept by themselves, by a bank or by a controlling authority. Such a ledger is referred to herein as an "evidence account", a term frequently used in practice. An evidence account is not a payment mechanism. Rather, it is used only for recording the conclusion, performance and value of supply contracts, with financing and payment being arranged independently. With an evidence account, the parties undertake a countertrade commitment of a given value and then conclude supply contracts in the two directions without having to negotiate a countertrade commitment for each individual supply contract. Evidence accounts may accommodate multiple parties on one or both sides. An evidence account may be particularly useful in a long-term countertrade transaction to monitor the cumulative value of the purchases in the two directions and thereby to assist the parties in dealing with imbalances that may develop.

39. The use of an evidence account may be subject to governmental regulations. Such regulations may determine the manner in which an evidence account is to operate and require administration of the account by a controlling authority such as the central bank or foreign trade bank. An evidence account administered by a controlling authority may provide the purchaser access to a wider variety of countertrade goods and trading partners than might be available without an evidence account administered by the controlling authority. Government regulations may also require authorization of evidence accounts. It may be provided that such authorization would be given only for countertrade transactions exceeding a minimum turnover and to parties with an established presence in a given country. In some cases, an evidence account is authorized with the restriction that purchases by third parties will not be counted towards fulfilment of the countertrade commitment; such a restriction may be imposed when the motive for permitting an evidence account is to establish a long term trading relationship with a particular party. The countertrade goods may be limited to those agreed upon by the parties or those that the controlling authority has an interest in promoting.

40. When the parties are free to establish an evidence account, they may decide to administer the account themselves or to engage a bank or banks to do so. A variety of structures are possible depending on whether the account is administered by one or both of the parties or by one or two banks engaged by the parties. For example, parallel accounts could be established by a party or a bank on each side of the transaction in which supplies are credited and purchases are debited. Each parallel account could in turn consist of two ledgers, one listing contracts concluded in each direction and the other recording payments. If banks are to administer the evidence account, the parties may wish to use the banks that handle payment for the supply contracts.

41. The countertrade agreement should specify the documentation required for triggering entries in the evidence account (e.g., copies of contracts, evidence of letters of credit, or shipping documents). Such documentary requirements should be in line with the provisions in the countertrade

agreement concerning the stage when the countertrade commitment is deemed fulfilled (see paragraphs 10 to 12 above). In order to minimize administrative burden, the parties may wish to align to the degree possible the documentary requirements for the evidence account with those of any governmental authority monitoring the countertrade transaction.

42. It is advisable that the parties address in the countertrade agreement deviations from the agreed upon ratio between the values of the shipments to be made in the two directions. It is advisable to agree that during the fulfilment period the values of the shipments may deviate from the agreed ratio, with the agreed upon ratio to be achieved upon the conclusion of the fulfilment period or at specified points in the fulfilment period. The parties may further agree that deviations during the fulfilment period must remain within a specified range. For example, during the fulfilment period the value of the shipments in one direction should be not less than 60 and not more than 120 per cent of the value of the shipments in the other direction. It may be agreed that failure by a party to conclude the supply contracts necessary to achieve the agreed upon ratio may be subject to sanctions (see chapters XI, "Liquidated damages and penalties", and XII, "Security for performance"). It is advisable to define in the countertrade agreement small deviations from the ratio that would be tolerated.

43. In order to minimize errors or discrepancies in the evidence account, the parties may agree to verify at fixed points of time the information entered in the account.

44. Where two banks are involved in administering the evidence account, the technical details of the account may be the subject of an interbank agreement. The countertrade parties have an interest in the contents of the interbank agreement, though they are not normally parties to it. It is therefore advisable that the parties consult with the banks to ensure that the evidence account established by the banks is acceptable to the parties.